CHAPTER 5

First City Bancorporation of Texas, Inc.

Name of Institution:	First City Bancorporation of Texas, Inc.
Headquarters Location:	Houston, Texas
Date of Resolution:	April 20, 1988
Resolution Method:	Open Bank Assistance Transaction
Date of Resolution:	October 30, 1992
Resolution Method:	Purchase and Assumption Transaction; FDIC created 20 bridge banks
Date of Resolution:	January 27, 1993
Resolution Method:	Purchase and Assumption Transaction—Various Acquirers

Introduction

In 1988, 279 banks failed or received assistance from the Federal Deposit Insurance Corporation (FDIC), the highest number in recent U.S. history. Of that total, 214, or 76.7 percent, were in the Southwest, with 174 in Texas alone.[1] Included in the 174 banks were the 60 subsidiary banks of First City Bancorporation of Texas, Inc. (First City), Houston, Texas. First City was a major Texas-based bank holding company; 59 of its 60 subsidiary banks were given open bank assistance (OBA) on April 20, 1988, to prevent their failure. The other affiliated bank failed one day earlier. The assistance to 59 individual banks represented the most banks ever resolved in one transaction by the FDIC. However, aspects other than the sheer volume of the First City transaction are noteworthy.

First, the negotiations for OBA were unusually lengthy and difficult, extending for more than seven months. Second, First City was unable to survive for long after the 1988 assistance. After an unsuccessful effort to save itself in 1991 by selling off some of its more profitable banks, the 20 remaining banks in the holding company failed in

1. There were 174 bank failures in Texas, 25 in Oklahoma, 13 in Louisiana, 1 in Arkansas, and 1 in New Mexico. FDIC, *Failed Bank Cost Analysis 1985–1990* (Washington, D.C.: Federal Deposit Insurance Corporation, 1991), 16-3, 16-6, 16-7.

1992. Third, when First City's two lead banks in Dallas and Houston became insolvent and were closed on October 30, 1992, the FDIC used its cross guarantee authority under the provisions of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989. The cross guarantee authority allowed the FDIC to assess insured depository institutions for the cost of the failures of other banks within the same holding company. When the FDIC invoked its cross guarantee authority for the projected losses of the two lead banks, the remaining 18 banks in the holding company became insolvent and were closed. Fourth, the FDIC again used its bridge bank authority and created 20 bridge banks, rather than creating only one bridge bank for all the First City banks.[2]

General Description of the Institution

In 1987, First City, headquartered in Houston, Texas, was an $11.2 billion organization with 60 banking subsidiaries. Of the 60 subsidiary banks, all were located in Texas except for one that was located in South Dakota. First City was an established banking firm that counted many industrial giants among its clients. In 1988, it was the fourth largest bank holding company in Texas.

Background

First City fell victim in the early 1980s to the downturns in the agriculture and energy markets, which were followed by a similar decline in real estate. First City was one of many Southwestern banking entities that had grown rapidly during the years of the oil boom. When the oil industry began to decline after 1981, First City, like many other banks, turned to real estate lending. That was happening at about the same time as savings and loan (S&L) institutions were permitted to enter into commercial real estate lending, and market prices skyrocketed upward.

2. The Competitive Equality Banking Act of 1987, as amended by FIRREA, provided the FDIC with the authority to establish a bridge bank to handle a failing institution. A bridge bank is a newly chartered, full-service national bank controlled by the FDIC. The original failed bank is closed by its chartering authority and placed in receivership. When appropriate, the FDIC establishes a bridge bank to provide the time needed to arrange a sale of the failed bank's assets and deposit liabilities. The bridge bank provides prospective purchasers the time necessary to assess the bank's condition in order to submit their offers. If no systemic risk (as described in section 13(c)(4)(G) of the Federal Deposit Insurance Act [FDI Act] of 1950) exists, the decision to "bridge" an institution must be based on whether a bridge bank structure will result in the least costly resolution for the failing institution. Under section 11(n) of the FDI Act, the FDIC may organize a bridge bank when one or more insured banks are "in default" or when the FDIC "anticipates" that one or more insured banks "may become in default." (Under section 3(x) of the FDI Act, "default" refers to the condition of an insured depository institution in which a judicial or an administrative decision has been reached pursuant to which a conservator, receiver, or other legal custodian is appointed for that institution.)

In 1982, First City's real estate lending accounted for less than 20 percent of its loan portfolio. However, by 1987, its total real estate portfolio was $3.2 billion, or more than 35 percent of all its loans. Much of the lending was in the riskier areas of construction and development loans.

Although 1987 was a fairly stable year for the country, with low inflation and declining interest rates, the Southwest was still having economic troubles. The Southwest's bank failures continued to rise, reaching 110 in the region in 1987.[3] About 39 percent of the surviving banks in the region had negative asset growth rates, causing the regional average asset growth rate to be negative for the second consecutive year. Nonperforming assets peaked at 4.2 percent of assets, and nonperforming loans constituted more than 10 percent of total loans and leases. Commercial office market vacancy rates in major Texas cities soared, reaching 40 percent in Austin, 31 percent in Houston, and 31 percent in Dallas. Those outside economic factors led to the deterioration of the quality of commercial loans, construction loans, and consumer loans in the various First City banks, causing large loan losses as well as a shortage of qualified borrowers.

The FDIC had been aware of First City's situation for some time and knew that some sort of intervention would be necessary. It was no surprise, then, when First City approached the FDIC for OBA. An outside investor group, headed by A. Robert Abboud, the former chief executive officer of First National Bank of Chicago, proposed the plan. The plan involved an injection of $500 million in new capital to be raised through a stock offering with the help of an investment banking firm. Control of First City would be assumed by a newly formed holding company. The injection of that much additional capital meant that the ownership of First City's common shareholders would be reduced to less than 2 percent of the total equity in the holding company.[4] Each shareholder would have received 1 share of stock in the new company for every 100 shares that they held in First City.[5] Bondholders were asked to exchange their claims for 35 cents to 45 cents on the dollar.[6] On September 9, 1987, the FDIC Board of Directors approved, in principle, an OBA agreement proposed by the Abboud group.

The Abboud investment group ran into several difficulties in raising the money, and the final assistance plan took months longer to finalize than expected. One of the initial problems was the stock market "crash" of October 19, 1987, when the Dow Jones industrial average dropped 508 points in a single day. That was the largest one-day decline in history, and the situation made potential investors anxious.

3. There were 62 bank failures in Texas, 33 in Oklahoma, and 15 in Louisiana. FDIC, *Failed Bank Cost Analysis 1985–1990*, 16-3, 16-6, 16-7.

4. FDIC News Release, "FDIC Grants Final Approval to Assistance Plan for Subsidiaries of First City Bancorporation, Houston, Texas," PR-82-88 (April 20, 1988).

5. "First City Takeover Concludes Next Week," *Reuters Financial Service* (April 8, 1988), Financial Report Section.

6. Barbara A. Rehm, "First City Deal May Be in Peril, Regulators Fear, But Company Confident It Will Complete Rescue," *American Banker* (April 18, 1988), 1.

Another problem encountered by the Abboud group was that their proposal for OBA, a part of which included the creation of a new holding company, required the approval of First City's shareholders and bondholders. The approval was no small item because the shareholders were being asked to reduce their holdings to less than 2 percent of First City's total equity, and bondholders were being asked to exchange their claims for 35 cents to 45 cents on the dollar. Then-FDIC Chairman L. William Seidman (who served from 1985 to 1991) stated,

> Requiring bondholders in the bank holding company to reduce their debt holding became the most difficult part of the deal. In Continental Illinois' [Continental Illinois National Bank and Trust Company, Chicago, Illinois] failure the bondholders had been protected, even though they were not insured. Most of First City's bonds had been dumped as its troubles became public, and they had been purchased for a few cents on the dollar by Wall Street arbitragers. . . . They reckoned that the Continental Illinois precedent would force us to cover all company debtors, including them, because we had no other way to handle such a large institution and would recoil from closing it down and risking the panic and huge losses that might occur in the weakened Texas economy.[7]

During the period when Abboud and his investor group were trying to raise money to rescue First City, another Texas bank holding company was in serious trouble. First RepublicBank Corporation (First Republic), Dallas, Texas, was the largest bank holding company in Texas, and it had reported major losses for 1987, along with a large percentage of nonperforming loans and liquidity difficulties.[8] First Republic was on the verge of failure and, because of interbank funding, a substantial number of affiliate banks were also at risk. The FDIC granted First Republic interim assistance on March 17, 1988, pending a final solution. Thus, the largest and the fourth largest banking institutions in Texas were both depending on FDIC assistance. First Republic's announcement on April 12, 1988, that it expected a $1.5 billion loss for the first quarter of 1988 further reinforced the perception of some investors that Texas was a "black hole" in terms of banking.[9]

Because the First City investor group had not been able to raise the money necessary to recapitalize, on March 29, 1988, the FDIC Board of Directors again extended the closing date for First City's proposal to April 20, 1988. On April 13, 1988, after a lengthy discussion of other options, the FDIC Board of Directors authorized final approval of Abboud's proposal to acquire First City. Things once again looked bleak,

7. L. William Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas* (New York: Times Books, 1993), 144.

8. See Chapter 6, First Republic Bank Corporation, for a full discussion of that transaction.

9. Rehm, "First City Deal May Be in Peril," 1.

though, when the Dow Jones industrial average dropped 101 points on April 14, 1988. Finally, the Abboud group raised the necessary funds by increasing the yield it was offering on a class of preferred stock in the new holding company.[10]

The proposal had included a provision for exchanging 90 percent of the holding company's outstanding bonds for 35 cents to 45 cents on the dollar. The FDIC eventually agreed to lower the 90 percent requirement in the original proposal to 70 percent. As late as April 18, 1988, two days before the FDIC's deadline, only 66.1 percent of the bondholders had agreed to the terms of the OBA. The original proposal from the investor group was to have been completed before the end of 1987. The transaction took more than seven months to complete after the Abboud group requested and received a total of five extensions.[11]

One final problem that had to be solved was that of the McAllen State Bank, McAllen, Texas, which had $590.7 million in assets and a negative $9 million in equity in April 1988. First City had acquired the McAllen bank in 1982 but had not changed the name. The condition of the bank, the largest in the Rio Grande Valley of south Texas, had deteriorated significantly in the preceding months. Rising losses in the McAllen bank had threatened to increase the cost of the pending bailout plan. Texas Banking Commissioner Kenneth W. Littlefield closed the bank on April 19, 1988. All deposit liabilities, including uninsured deposits, were transferred to First City, Texas-Houston, N.A. (First City Houston), Houston, Texas, in a purchase and assumption (P&A) transaction. All assets were also transferred to First City Houston, except for $50,000 retained by the FDIC for expected liquidation expenses. All customer services at the McAllen facility were provided without interruption, and the McAllen office began to function as a branch of First City Houston, the flagship bank of First City. After the bank in McAllen was closed, the FDIC and First City were able to proceed with the OBA transaction.[12]

The Resolution—April 20, 1988

On April 20, 1988, one day after the closing of the bank in McAllen, the FDIC's Board of Directors announced final approval of an assistance plan to recapitalize and to restore financial health to the remaining 59 subsidiary banks of First City.[13] At the time of the assistance, First City held $9.2 billion in deposits, or 6.4 percent of all deposits in Texas. Terms of the assistance included the following:

10. David LaGesse, "Drexel Stake Seals Rescue of First City," *American Banker* (April 20, 1988), 1.

11. Rehm, "First City Deal May Be in Peril," 1.

12. FDIC News Release, "FDIC Approves Acquisition of Deposits and Liabilities of McAllen State Bank, McAllen, Texas," PR-83-88 (April 19, 1988).

13. FDIC News Release "FDIC Grants Final Approval to Assistance Plan for Subsidiaries of First City Bancorporation, Houston, Texas," PR-82-88 (April 20, 1988).

- $500 million in new capital was raised through a stock offering. The new private investors assumed control of the First City banks through a newly formed holding company, First City Acquisition Corporation (FCAC). The ownership of First City's common stock shareholders was reduced to less than 2 percent of the total equity.
- The FDIC received warrants, exercisable for five years, to purchase 5 percent (1,030,636 shares) of the common stock of FCAC at $20.94 per share, which was the initial offering price of the stock.[14] In addition, the FDIC purchased $43 million (2,059,456 shares) of junior convertible preferred stock in FCAC. That stock could be converted into a 10 percent interest in the common stock of FCAC.
- Management and policy direction of the company was to be provided by a new management team and board of directors headed by Abboud.
- Assistance to the First City subsidiary banks took the form of $970 million in "Senior Subordinated Interest Notes" (the FDIC Notes) from the FDIC. The FDIC Notes bore interest at the U.S. Treasury bill rate plus one-half of 1 percent, with principal payable in 10 equal semiannual installments. In exchange for the FDIC Notes, the FDIC received 97 million shares of preferred stock in the Collecting Bank (described later in this chapter). First City guaranteed the repurchase of the preferred stock for a minimum of $100 million in 1998.
- The FDIC did not purchase any assets held by the assisted banks. Approximately $1.7 billion in nonperforming and troubled assets were transferred to a separate entity (the Collecting Bank or bad bank) created to service such assets. Notes from the First City subsidiary banks funded the entity. Collections were to go first to repay the subsidiary banks, then $100 million to the FDIC to repurchase the preferred stock, and finally to the previous shareholders of First City.

First City was able to exchange stock for approximately 68 percent ($153.4 million) of about $225 million in publicly held long-term debt for 35 cents to 45 cents on the dollar. The remaining bondholders who held out and caused the delay were rewarded because the price of the bonds on the secondary market rose after the assistance agreement was finalized. Chairman Seidman was quoted as saying that the FDIC would change the terms of future assistance agreements to avoid the potential of similar pressure from debtholders. "I wouldn't say they made a lot of friends, but that's the marketplace at work," he said of the Wall Street brokerages that bought and held the First City bonds.[15]

14. FDIC, *Equity Investment Portfolio: Bank Insurance Fund* (December 31, 1993), 18.

15. Thomas C. Hayes, "Bailout Plan for First City Clears Hurdle," *The New York Times* (April 20, 1988), sec. D, 1.

The assistance agreement resulted in $1.751 billion in loans being transferred to the Collecting Bank. However, a sizable amount of questionable-value loans (approximately $1 billion) still remained on the books of the subsidiary banks.[16]

First City's Problems Continue

In the beginning, the new First City was profitable. By August 1, 1989, a little more than a year after the assistance agreement was finalized, First City repurchased the FDIC's entire block of junior convertible preferred stock for $69.1 million and purchased the FDIC's common stock warrants for $39.4 million.[17]

By 1990, bank failures in the Southwest dropped to 120, though they still accounted for more than 70 percent of all bank failures in the country. In that same year, 2.9 percent of all commercial banking assets were classified as troubled loans, which was the highest level seen since 1982.[18]

In 1990, First City Houston had to honor a $140 million letter of credit to Citibank, Spain. The letter of credit had as collateral a note secured by real estate in Spain valued at $200 million. First City Houston had expected to earn a substantial fee on a transaction that it had analyzed as having minimal risk. However, it later learned that Spanish law made it difficult for lenders to seize collateral. Upon paying the letter of credit, First City Houston had to subsequently sell participations in the problem loan to 20 of the First City subsidiary banks to avoid exceeding its lending limits. By the fourth quarter of 1990, the loan was placed in nonperforming status.

In the third quarter of 1990, First City reported its first loss since the assistance. The loss, which amounted to $102 million, included a $77 million write-off on notes owed by the Collecting Bank to the subsidiary banks. In the fourth quarter of 1990, losses continued at First City, as it reported a loss of $166 million.[19] For all of 1990, First City reported a loss of $180 million.

In March 1991, the First City board of directors, recognizing that the institution might be failing again, voted to remove Abboud as chief executive officer and replace him with C. Ivan Wilson, a long-time First City banker. Abboud, however, did remain a member of the board. The bank then developed a plan to raise needed capital. The plan involved selling off profitable subsidiaries, negotiating less expensive leases, and raising

16. David LaGesse, "Abboud Sets Lofty Goals for First City: Investor Plans Growth in Consumer and Energy Market," *American Banker* (April 21, 1988), 2; James E. Heath, FDIC Division of Research and Statistics, *Bank Failures (Texas),* working paper (1997), 10.

17. FDIC, *Equity Investment Portfolio: Bank Insurance Fund,* 18.

18. Troubled loans are loans that are 90 days or more past due, nonaccrual loans, and owned real estate.

19. John W. Milligan, "Who Shot First City," *Institutional Investor,* vol. 26, no. 3 (March 1992), 43; Heath, *Bank Failures (Texas),* 20.

$100 million by selling stock.[20] On July 30, 1991, First City requested prepayment from the FDIC of the remaining $485 million of assistance notes to increase First City's liquidity. The FDIC Board of Directors approved the request. On October 31, 1991, the FDIC wrote off its investment of $970 million in the 97 million preferred shares of First City.[21] The Office of the Comptroller of the Currency (OCC) classified $270 million of Collecting Bank notes as nonaccrual assets as of December 31, 1991.[22] For 1991, First City reported a loss of $252 million; over its last six quarters its aggregated losses amounted to more than $480 million.

The Collecting Bank

The FDIC OBA to First City had required First City to create a "Collecting Bank"[23] to dispose of certain troubled assets held by the subsidiary banks. First City's income from the Collecting Bank nearly equaled First City's net income during 1988 and 1989, which were First City's only profitable years after the OBA. A study completed by the General Accounting Office (GAO) in 1994 found that, if it had not been for the $73 million in interest and fee income paid to First City by the Collecting Bank in 1988, First City would have lost about $7 million that year. Although First City's 1989 net income did not depend completely on the Collecting Bank's interest and fees, the GAO found that such income accounted for nearly $100 million of the $112 million in net income earned by First City during 1989.[24]

The anticipated success of the recapitalized First City had been partially based on the assumption that First City, including the loans in the Collecting Bank, would experience no further deterioration. That assumption proved to be incorrect. Problems with both precapitalization and postcapitalization loan portfolios resulted in significant loan charge-offs and depletion of bank equity. The GAO study found that about $270 million in assets that originated before the 1988 recapitalization at the First City subsidiary banks in Houston and Dallas resulted in nearly $75 million in losses. Those problems

20. Stephanie Anderson Forest, "First City Goes Down for the Second Time," *Business Week,* no. 3293 (November 16, 1992), 100; Milligan, "Who Shot First City," 43; Heath, *Bank Failures (Texas)*, 11.

21. FDIC, *Equity Investment Portfolio: Bank Insurance Fund,* 18.

22. Harrison Young, Director, FDIC Division of Resolutions, and Stephen Willard, Assistant Director, FDIC Division of Resolutions, Memorandum to the FDIC Board of Directors, "Early Resolution of the Insured Banks of First City Bancorporation of Texas, Inc." (January 10, 1992).

23. The Collecting Bank was a nationally chartered bank whose sole purpose was to liquidate almost $2 billion in troubled assets it received from the First City banks as a part of the 1988 recapitalization. The Collecting Bank did not accept insured deposits and, as a general rule, did not extend credit. "Failing Banks: Lessons Learned from Resolving First City Bancorporation of Texas," *Report to the Chairman and Ranking Minority Member, Committee on Banking, Housing, and Urban Affairs, U.S. Senate* (Washington, D.C.: General Accounting Office, March 1995), 4.

24. "Failing Banks: Lessons Learned from Resolving First City Bancorporation of Texas," 33-34.

forced First City to charge off nearly $200 million of Collecting Bank notes by October 1992, at which time all First City banks failed.[25]

When the Collecting Bank was formed, First City's other subsidiary banks transferred to it $1.751 billion in problem assets. In exchange for the problem assets, the Collecting Bank gave the subsidiary banks "Senior Notes" of $781 million and $970 million in preferred stock in the Collecting Bank. In a simultaneous transaction, the subsidiary banks transferred the $970 million in preferred stock to the FDIC, and the FDIC gave the subsidiary banks $970 million in FDIC Notes to recapitalize the banks. The FDIC was to amortize the FDIC Notes semiannually at $97 million (plus interest), resulting in a five-year payoff.[26] The terms of the transaction required that the Senior Notes and the FDIC Notes be paid off completely before any dividends could be paid on the preferred stock. Redemption of the preferred stock was to begin after April 19, 1993, and could not be accomplished as long as any Senior Notes or FDIC Notes were outstanding. First City was required to purchase the FDIC's preferred stock in the Collecting Bank in 1998 for a minimum of $100 million and, as of April 12, 1991, had escrowed $44 million for that purpose.

By March 1991, the subsidiary banks had transferred additional problem assets and paid expenses of the Collecting Bank in the amount of $285 million, and the Collecting Bank had issued an additional $285 million in Senior Notes, bringing the total of the Senior Notes issued to $1.066 billion. The Collecting Bank had paid $610.6 million in principal payment on the notes, resulting in the reduction of the April 1991 Senior Note balance to $455 million. Payment of the remaining notes in full was doubtful, however, because the Collecting Bank had only $462 million in assets remaining and almost half of its loans were illiquid.[27]

Even though the FDIC was not an owner of the Senior Notes, the assistance agreement required the FDIC's approval to modify them. The FDIC agreed to the modification of the Senior Notes as follows:[28]

- The subsidiary banks had established a $100 million loan loss reserve against the Senior Notes as a result of an OCC examination. The subsidiary banks were allowed to eliminate the reserve by forgiving $100 million on the Collecting Bank's debt, resulting in the reduction of the April 1991 Senior Note balance to $355 million. The Collecting Bank issued a new note (the 1991 Senior Note) for $355 million, which resulted in its paying interest on a lower amount. The pur-

25. "Failing Banks: Lessons Learned from Resolving First City Bancorporation of Texas," 33-34.

26. In July 1991, at First City's request, the FDIC agreed to prepay the remaining $485,000 balance of the notes.

27. John W. Stone, Director, FDIC Division of Supervision, through Paul G. Fritts, Executive Director, FDIC Divisions of Supervision and Resolutions, Memorandum to the FDIC Board of Directors, "First City Bancorporation of Texas, Inc., Houston, Texas (First City), Recommendation to Approve the Modification of the Senior Notes Issued by the Collecting Bank, N.A., (Collecting Bank)" (April 12, 1991).

28. Stone, "First City Bancorporation of Texas, Inc., Houston Texas (First City), Recommendation to Approve the Modification of the Senior Notes Issued by the Collecting Bank, N.A. (Collecting Bank)."

pose was to improve the Collecting Bank's cash flow and avoid placing the 1991 Senior Note on nonaccrual.

- The Collecting Bank had been required to apply net collections in the following priority. First, it paid its management incentive fee. Second, it paid the subsidiary banks on a pro rata basis their accrued interest from the Senior Notes. Third, it paid the subsidiary banks on a pro rata basis the remaining available cash to reduce the principal of the Senior Notes. The FDIC agreed to the modification, which allowed for the repayment of all the interest and principal on the Senior Notes before any management service fees were paid. However, the unpaid fees would continue to earn interest.

More Problems Arise

In January 1992, the FDIC Board of Directors was advised that First City could be expected to fail in late 1992. The advice was based on the projected insolvency of its lead bank, First City Houston, and on the FDIC's cross guarantee authority.[29] Other problems at First City included its overexpansion in real estate, both in and out of Texas; an overvaluation of First City loan portfolios; and an overly optimistic, serious miscalculation on the recovery of the Texas economy. In addition, First City's lending practices and policies were progressively deteriorating. Finally, dwindling collections impaired cash flow, and the FDIC started to develop a resolution plan for First City.[30]

By March 31, 1992, four of First City's subsidiary banks failed to meet minimum regulatory capital guidelines. Those banks—First City, Texas-Austin, N.A. (First City Austin), Austin, Texas; First City, Texas-Dallas (First City Dallas), Dallas, Texas; First City, Texas-Houston, N.A. (First City Houston), Houston, Texas; and First City, Texas-San Antonio, N.A. (First City San Antonio), San Antonio, Texas—represented approximately 60 percent of the combined First City assets.

By June 1992, the holding company had approximately $22 million in outstanding debt due on September 15, 1992. In addition, the FDIC held a $23 million fully secured note due on February 28, 1993, that was the result of an agreement First City had previously reached with the FDIC in settling potential claims by the FDIC against a

29. The cross guarantee authority allows the FDIC to recover all or part of the losses incurred in liquidating or aiding a troubled institution from other institutions that have the same ownership as the failing institution. Institutions with this type of ownership arrangement are called "commonly controlled" institutions. Assessment of cross guarantees may create a liquidity strain that results in failure of the affiliate or, in some cases, immediate insolvency of the affiliate.

30. Harrison Young, Director, FDIC Division of Resolutions, Robert H. Hartheimer, Associate Director, FDIC Division of Resolutions, and Stephen Willard, Assistant Director, FDIC Division of Resolutions, through Paul G. Fritts, Executive Director, FDIC Divisions of Supervision and Resolutions, Memorandum to the FDIC Board of Directors, "Early Resolution of the Insured Banks of First City Bancorporation of Texas, Inc." (June 19, 1992).

number of past and present directors and officers of the holding company.[31] First City doubted that it would be able to pay the debt obligations due in September and indicated that the holding company might become the subject of voluntary or involuntary bankruptcy proceedings.

The FDIC Board of Directors was briefed on First City's deteriorating condition and on various options of resolution on June 23, 1992. First City proposed another OBA transaction to the FDIC that would have been a whole bank transaction in which an acquiring holding company (New First City) acquired First City by merger or equivalent transaction. Although the FDIC would have acquired no assets, it was asked to agree to share in the losses on a $1.8 billion pool of assets. The proposal was rejected, and the FDIC advised First City on July 21, 1992, not to give the impression in public disclosures that the FDIC was likely to provide OBA. Other financial entities expressed interest in First City only on a closed bank basis.

By August, First City had given up on its search for a merger partner. It announced a plan to raise new capital to meet regulatory standards without FDIC assistance.[32] The plan projected that it would take until December 1992 at the earliest to raise the capital. Regulators doubted that the bank could raise enough capital by that time to meet regulatory standards.[33]

The Resolution—October 30, 1992

An annual OCC bank examination initiated in September 1992 confirmed that loan losses were mounting at First City Houston. In response, on October 30, 1992, Acting Comptroller of the Currency Stephen R. Steinbrink closed First City Houston, a nationally chartered bank. Texas Commissioner of Banking Catherine A. Ghiglieri closed First City Dallas, a state chartered bank. The FDIC then exercised the cross guarantee authority granted by FIRREA to assess the other 18 subsidiary banks for losses on First City Houston and First City Dallas. The use of the cross guarantee authority rendered those 18 banks insolvent, and they were closed by their respective chartering authorities, that is, the OCC closed the nationally chartered banks, and the Texas Commissioner of Banking closed the state chartered banks.

The FDIC established 20 separate bridge banks to assume deposits and certain other liabilities and assets of the failed banks.[34] Edward G. Harshfield, former chairman of Federal Capital Bank, N.A., Washington, D.C., and chairman of EH Thrift Manage-

31. Young, Hartheimer, and Willard, through Fritts, "Early Resolution of the Insured Banks of First City Bancorporation of Texas, Inc."

32. Steven Greenhouse, "U.S. Closes First City Bancorp," *The New York Times* (October 31, 1992).

33. Forest, "First City Goes Down for the Second Time," 100; Heath, *Bank Failures (Texas)*, 13.

34. See Part I, Resolution and Asset Disposition Practices, Chapter 6, Bridge Banks, for a discussion of bridge banks.

ment, Inc., Chicago, Illinois, was appointed chief executive officer of the bridge banks. The FDIC announced that it planned to seek proposals for the acquisition of the 20 new bridge banks and return them to the private sector in approximately three months.[35]

In the resolution of First Republic in 1988, all failed subsidiary banks had been placed in one bridge bank and marketed as one institution. The First City resolution was handled differently, and each of the 20 banks was marketed separately. For the 16 better capitalized bank subsidiaries of First City (all those except First City Austin, First City Dallas, First City Houston, and First City San Antonio), the FDIC did not expect to incur any losses, so all deposits, including about $140 million in 5,700 accounts exceeding the $100,000 insurance limit, were transferred to the new bridge banks. The FDIC expected that there would be losses to the FDIC from the other four First City banks—First City Austin, First City Dallas, First City Houston, and First City San Antonio. The FDIC Board of Directors therefore determined that having the FDIC absorb the uninsured depositors' share of the losses in the four banks would not result in the least costly resolution, as required by the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991.

For the Austin, Dallas, Houston, and San Antonio bank subsidiaries, all deposits under the $100,000 deposit insurance limit were fully protected and were transferred to the new bridge banks. Deposits exceeding the insurance limit totaling $260 million in 5,000 accounts were not transferred to the new banks. Owners of those deposits received checks equal to 80 percent of their claims, an amount based on the estimated recovery of the assets in those banks. Provisions were made so that, if collections on the sale of the four failed banks' assets exceeded the 80 percent recovery estimate, those owners of uninsured deposits might receive additional payments on their claims.[36]

On November 23, 1992, one month after the failure of its 20 subsidiary banks, the First City holding company filed for bankruptcy protection from its creditors.

Sale of the Bridge Banks—February 13, 1993

Even before First City failed in October 1992, six banking entities had notified the FDIC of their interest in purchasing all or part of the First City banks.[37] In all, after marketing the bridge banks, the FDIC received 111 bids for the 20 banks from 32 potential purchasers. On January 27, 1993, the FDIC announced the sale of the 20 bridge banks, with more than $9 billion in total assets, to 12 different financial

35. FDIC News Release, "FDIC Establishes 20 New Bridge Banks to Assume Subsidiaries of First City Bancorporation of Texas, Inc., Houston, Texas," PR-150-92 (October 30, 1992).

36. FDIC News Release, PR-150-92.

37. Young, Hartheimer, and Willard, through Fritts, "Early Resolution of the Insured Banks of First City Bancorporation of Texas, Inc."

institutions through P&A transactions effective February 13, 1993. Texas Commerce Bancshares (Texas Commerce), Houston, Texas, a wholly owned subsidiary of Chemical Banking Corporation, acquired the largest share of the First City franchise. Texas Commerce acquired five bridge banks and approximately 73 percent of the total assets of all the bridge banks. The five banks acquired by Texas Commerce were the two largest banks (Houston and Dallas) and the banks in Beaumont, El Paso, and Midland.[38]

The basic provisions of the sale transactions were as follows:

- The acquiring institutions assumed all bridge bank deposits and nearly all other bridge bank liabilities.
- The acquiring institutions paid or received cash equal to the difference between assets purchased and liabilities, plus or minus the amount of their respective bids.[39]
- The acquiring institutions purchased securities at market value, and they purchased all other assets except owned real estate and in-substance foreclosed loans at book value. The acquirers were given an option to purchase the banking premises at fair market value.

The aggregate premium received for the 20 banks was $434 million.[40] In 17 of the failed banks, the acquiring institutions agreed to absorb all losses on assets acquired. In the other three banks, which were in Austin, Dallas, and Houston, the franchises were sold with five-year "loss sharing" arrangements on approximately $1.8 billion of loans.[41] Those assets are referred to as the loss sharing assets. During the five-year period, the FDIC reimbursed the relevant acquiring institution for 80 percent of verified net charge-offs on the loss sharing assets. The acquiring institution absorbed the remaining 20 percent of loss. Some provisions were made for increased payments from the FDIC if acquiring bank losses reached certain designated levels.[42]

The premiums paid for the banks exceeded the original estimate of bid amounts expected.[43] After the bidding, the FDIC announced on January 23, 1993, that it would advance an additional 10 cents for every dollar of uninsured claims for depositors (but not

38. FDIC News Release, "FDIC Announces Sale of 20 Bridge Banks Established in October to Resolve Closed Bank Subsidiaries of First City Bancorporation of Texas, Houston; Agency Also Adds to Previous Payment to Certain Uninsured Depositors," PR-7-93 (January 27, 1993).

39. FDIC News Release, PR-7-93.

40. FDIC News Release, PR-7-93.

41. Loss sharing is a provision of certain purchase and assumption transactions the FDIC introduced in 1991. Loss sharing is designed to sell as many assets as possible to the acquiring bank and have it manage and collect the nonperforming assets in a manner that aligns the interests and incentives of the acquiring bank with those of the FDIC. In a loss sharing agreement, the FDIC agrees to absorb a significant portion of the loss, typically 80 percent, on a specified pool of assets, while the acquiring bank absorbs the rest of the loss. See Part I, Resolution and Asset Disposition Practices, Chapter 7, Loss Sharing, for a full discussion of this subject.

42. FDIC News Release, PR-7-93.

43. FDIC News Release, PR-7-93.

other creditors) of the closed bank in Dallas and for the uninsured depositors and other unsecured creditors of the Austin and San Antonio banks. The FDIC did not authorize an additional advance dividend for uninsured depositors and creditors of the Houston bank.[44]

The FDIC had a reason for the disparate treatment of failed bank depositors and creditors. Sixteen of the failed banks had had higher amounts of capital when they were closed, and the FDIC expected no loss, so depositors and general creditors in those banks were all paid in full. However, the failed banks in Austin, Dallas, Houston, and San Antonio were initially expected to cause losses to the Bank Insurance Fund (BIF). In those four institutions, only insured deposits had been protected at the time the banks failed. The failed banks in Austin, Houston, and San Antonio all had been national banks, but the failed bank in Dallas had been a state chartered bank. Because of the Texas depositor preference law, which stated that all depositors must be paid before general creditors could be paid, the FDIC was unable to pay advance dividends to general creditors of the Dallas bank the way it could to general creditors of the banks with national charters.[45] On March 30, 1994, the FDIC announced that all creditors with valid claims against the First City receiverships would receive the full principal amount of their claims along with interest as provided by Texas state law.[46]

Shareholder Litigation

After receiving bids for First City's assets, the FDIC announced it expected to net a surplus of $60 million. Any surplus was to be returned to the holding company. Harrison Young, then FDIC's director of the Division of Resolutions, said, "I was astonished by how good a deal we'd gotten. By offering the [First City] banks separately, we got better premiums."[47] At the time the banks were closed, the FDIC expected the BIF to take a sizeable loss. The FDIC's original estimate of the loss was $500 million. However, the

44. FDIC News Release, PR-7-93.

45. At the time the First City banks failed, Texas had a law known as "depositor preference," which required that all depositors of a failed bank be paid in full before any general creditors could be paid. (See *Texas Banking Code,* section 36.312.) Such was not the case for national banks, in which uninsured depositors and general creditors were treated ratably. The Texas Commissioner of Banking had reservations about closing the Dallas bank, which was a state chartered bank. She knew that banks that had sold federal funds to the Dallas bank would be considered general creditors and would not receive the full amount of their federal fund loans until all depositors had been paid in full. Banks that had sold federal funds to one of First City's national banks would have received payment on the same pro rata basis as uninsured depositors. The commissioner was concerned that this disparate treatment might lead to banks' giving priority to the national banks when selling their federal funds, resulting in an advantage for national banks over state chartered banks. The disparity that gave the commissioner cause for concern was eliminated when Congress enacted a national depositor preference statute on August 10, 1993 (*U.S. Code*, volume 12, section 1821[d][11]) that eliminated the inconsistent treatment of depositors in the various states.

46. FDIC News Release, "FDIC Reports Projected Losses for Receiverships," PR-20-94, (March 30, 1994).

47. Kelly Holland, "The Feds May Have Bolted the Door Too Quickly," *Business Week*, no. 730 (February 8, 1993), 158; Heath, *Bank Failures (Texas)*, 30.

FDIC was able to sell the failed bank franchises to other institutions for a premium of $434 million and was also able to minimize some of its projected losses through the three loss sharing agreements, although the FDIC did take ownership of some loans.[48]

However, First City holding company officials believed that a surplus close to $400 million to $600 million could be projected. On September 24, 1993, First City filed suit against the OCC, Texas Commissioner of Banking Catherine A. Ghiglieri, and the FDIC, in both its corporate and receivership capacities, alleging improper closure of First City Dallas and First City Houston, improper assessment of the cross guarantees, and mishandling of receivership responsibilities. The lawsuit sought $1 billion in compensatory damages and $2 billion in punitive damages.

In January 1994, the FDIC board of directors and First City announced a tentative settlement of the pending litigation, subject to the approval of the bankruptcy court. Under the terms of the proposed agreement, the settlement would resolve all claims and was to be funded in at least two stages: (1) an initial payment in cash and other assets from surplus funds, and (2) one or more additional payments of the total remaining surplus after the FDIC could ascertain that its insurance fund and all other creditors would be repaid in full.[49]

In May 1995 the bankruptcy court approved the previously announced settlement with the FDIC. Under the settlement, it was estimated that the FDIC would return to First City $125 million in cash and $55 million in loans and real estate. The FDIC would also return—at face value—$75 million from a reserve against a pool of distressed loans held by Texas Commerce and Frost National Bank, San Antonio, Texas. In addition, the FDIC would provide funds to allow restitution to those depositors in the First City banks in Austin, Dallas, Houston, and San Antonio whose deposits were not fully insured and who were required to take approximately 80 cents to 90 cents on the dollar on the amounts over the $100,000 insurance limit. All other creditors were to be paid in full. Senior preferred shareholders would be paid over two years, and junior preferred shareholders would receive between $100 million and $150 million, depending on the liquidation value of the returned assets, as well as 35 percent of the new company's common stock. Common shareholders would get 15 percent of the new company's stock, with the remaining 50 percent going to shareholders of J-Hawk Corporation, Waco, Texas, whose merger with First City had been approved by the bankruptcy court at the same time it approved the settlement with the FDIC. The total value of the settlement was about $350 million.[50]

48. "FDIC Plans Settlement with First City in Litigation over 1992 Bank Closures," *BNA's Banking Report*, vol. 62 (January 3, 1994), 37.

49. "Receivership Challenge: FDIC Agrees to Rules in First City Settlement," *Litigation Reporting Service* (January 1994), 5938.

50. Joseph M. Grant, *The Great Texas Banking Crash: An Insider's Account* (Austin, Texas: University of Texas Press, 1996), 248.

The Stock Transactions

In the First City OBA transaction, the FDIC purchased $43 million (2,059,456 shares) of junior convertible preferred stock in FCAC. That stock could be converted into a 10 percent interest in the common stock of FCAC. Dividends of $2.1 million were received on the stock before sale. The stock was sold to First City in August 1989 for $69.1 million, which represented a gain to the FDIC of $26 million.

The FDIC also received warrants, exercisable for five years, to purchase 5 percent (1,030,636 shares) of the common stock of FCAC at the initial offering price of the stock of $20.94 per share. The FDIC exercised the warrants at $20.94 per share and sold them the same day in August 1989 to First City at $38 per share for a total of $39.4 million, which represented a gain to the FDIC of $17.8 million.

Finally, the FDIC provided $970 million in FDIC Notes to the First City subsidiary banks. In exchange for the notes, the FDIC received 97 million shares of preferred stock in the Collecting Bank. When it became apparent that the Collecting Bank would be unable to pay back the Senior Notes, the FDIC wrote off the value of its shares in 1991. A summary of the stock transactions is shown in table II.5-1.

FDIC Resolution Costs

The 1988 resolution of First City is the fourth most costly resolution in FDIC's history. The total cost of the transaction was approximately $1.1 billion, or about 10 percent of the failed banks' assets. See table II.5-2 below for a breakdown of the resolution costs.

As in the First Republic and MCorp resolutions, the acquirer, in this case the new owners of First City, took on ownership of and responsibility for administering and collecting the problem assets. However, the FDIC did not retain any ongoing mark-to-market responsibility for those assets nor did it enter into an asset management contract with the acquirer. The FDIC did provide $970 million in FDIC Notes to the First City subsidiary banks, who in turn funded the Collecting Bank that was responsible for administering and collecting the problem assets. In return, the FDIC received 97 million shares of preferred stock. Unfortunately, the Texas economy continued to deteriorate and the problem assets continued to deteriorate, resulting in higher losses than were originally expected. As a result, the FDIC wrote off its $970 million preferred stock investment in late 1991. Therefore, the significant costs to the FDIC in this transaction were the $970 million it provided in up-front assistance and the $193 million in interest expense on the notes provided to First City. Partially offsetting those expenses was about $35 million that the FDIC recovered from settlement of the directors and officers' claim, $13 million that the FDIC received as part of the 1995 settlement with the holding company, and approximately $46 million it received from dividends and gains on the sale of the junior convertible preferred stock and warrants to First City in 1989.

Table II.5-1

A Summary of the FDIC's Stock Transactions in the First City Open Bank Assistance Transaction

Date	Transaction	Beginning Number of Shares	Shares Sold, Written Down, Converted	FDIC Stock/ Equity Investment	FDIC Proceeds from Sales	FDIC Book Value of Transaction	Gain or Loss on Transaction	FDIC Dividend Income
				Convertible Junior Preferred Stock, Series D				
04/19/88	Original purchase	2,059,456		$43,125,009				
08/23/89	Dividends prior to sale							$2,059,456
08/23/89	Sale		(2,059,456)		$69,146,235	$43,125,009	$26,021,227	
	Totals	**2,059,456**	**(2,059,456)**	**$43,125,009**	**$69,146,235**	**$43,125,009**	**$26,021,227**	**$2,059,456**
				Common Stock Warrants				
08/23/89	Stock Warrants traded at $20.94 per share	1,030,636		$21,581,518				
08/23/89	Sale		(1,039,636)		$39,380,295	$21,581,518	$17,798,777	
	Totals	**1,030,636**	**(1,039,636)**	**$21,581,518**	**$39,380,295**	**$21,581,518**	**$17,798,777**	**$ 0**
				Preferred Stock				
04/19/88	Purchase with a note payable	97,000,000		$970,000,000				
10/31/91	Write off of worthless stock		(97,000,000)		$ 0	$970,000,000	($970,000,000)	
	Totals	**97,000,000**	**(97,000,000)**	**$970,000,000**	**$ 0**	**$970,000,000**	**($970,000,000)**	**$ 0**
Grand Total, All Stock		100,090,092	(100,099,092)	$1,034,706,527	$108,526,530	$1,034,706,527	($926,179,996)	$2,059,456

Source: FDIC, *Equity Investment Portfolio, Bank Insurance Fund* (December 31, 1993).

Table II.5-2

FDIC Resolution Costs for the 1988 First City Open Bank Assistance Transaction as of December 31, 1995

($ in Thousands)

FDIC's Expenses		
Purchase of preferred stock in the Collecting Bank	$970,000	
Interest expense on note	193,132	
Purchase of 2.1 million shares convertible junior preferred stock in FCAC	43,125	
Exercise of common stock warrants	21,582	
Nonrecoverable insurance expense	854	
Expenses on bond claim	25	
FDIC's Total Expenses		**$1,228,718**
FDIC's Recoveries		
Dividends on convertible junior preferred stock	$2,059	
Sale of convertible junior preferred stock	69,146	
Sale of common stock	39,380	
Settlement of directors and officers' claim*	35,066	
Interest income on directors and officers' note	898	
Recovery on preferred stock*	13,062	
FDIC's Total Recoveries		**$159,611**
FDIC's Total Resolution Cost		**$1,069,107**

*Per the Amended Settlement Agreement with First City Bancorporation in June 1995, the FDIC received $31 million related to outstanding issues on the directors' and officers' settlement and the Collecting Bank. Of that amount, $19 million was applied to the directors' and officers' settlement and $13 million was applied as recovery on the preferred stock. The amounts are reflected in the above figures.

Source: FDIC Division of Finance.

The second resolution of First City in 1992 resulted in no cost to the FDIC and in an aggregate surplus for the 20 First City receiverships. As part of the 1995 settlement with the holding company, the remaining surplus was ultimately used to pay in full the remaining uninsured depositors and creditors and then was paid to the holding company.

The second resolution resulted in a surplus for several reasons. First, the Texas economy, especially the real estate markets, was on an upswing and improved significantly after the resolution, thus increasing the value of the assets retained by the FDIC as well as the assets held by the acquirers. In addition, the structure of the transaction allowed for a highly competitive bidding process. Bidders were allowed to bid on each of the 20 banks individually as well as any combination thereof. This increased competition and allowed bidders to bid only on those banks they really wanted. Some banks would be worth more to some acquirers than to other acquirers. As a result, the FDIC received a $434 million premium, which was much higher than was expected.

In addition, the structure of the transaction allowed the FDIC to sell a significant portion of the assets with no ongoing exposure to the FDIC. The FDIC was able to sell 17 of the 20 First City banks on a "whole bank" basis without any ongoing assistance from the FDIC. In the other three First City banks, the FDIC offered loss sharing on a total of about $1.8 billion in assets, which was about one-third of the assets at the three banks at the time of resolution. In total, the FDIC was able to pass more than $8.5 billion, or more than 90 percent, of the First City assets to the acquirers of the 20 First City banks. Of those assets, only 20 percent had any FDIC commitment for ongoing assistance.

Another reason for the surplus was that the loss sharing agreement on the three First City banks was an extremely cost-effective method of asset disposition for the FDIC. Over the life of the agreement, approximately $2.5 billion in assets, including $1.8 billion initially and $0.7 billion in subsequent advances and additions, were covered by the loss sharing agreement. On the $2.5 billion in assets, the FDIC's total loss sharing payments totaled $82 million, which was only about 3 percent of the total book value of the assets. Finally, the FDIC's ability to assess the 18 affiliated banks for the projected losses of the 2 insolvent lead banks in Houston and Dallas provided the FDIC with a mechanism to recover the value of the other First City banks, which were generally in better financial shape.

Lessons Learned

The FDIC learned many lessons with the resolution of First City.

Open Bank Assistance—1988

When First City initially approached the FDIC in 1987 for OBA, the FDIC's standard practice in the resolution of failing banks was to arrange a P&A transaction with a healthy institution and to protect all depositors, but not shareholders and bondholders, against loss. Any OBA granted by the FDIC was expected to achieve similar results. The proposal from the Abboud group met those requirements, as the proposal indicated that the former shareholders' investments in the new holding company would be reduced to a nominal amount, and the bondholders would accept 35 percent to 45 percent of the balance due them. However, because of the manner in which Continental Illinois had been resolved three years earlier, the bondholders may have had little fear that the First City banks actually would be closed (which would cause them to lose their entire investments). Therefore, it was difficult for the Abboud group to complete a transaction that would substantially reduce the expected return of the bondholders and shareholders and still get their approval. Consequently, the negotiations for the First City resolution were unusually long and difficult.

As of 1997, First City was the largest banking institution ever to receive OBA and subsequently fail.[51] The FDIC's experience with First City can be viewed almost as the "last straw" for OBA. The number of OBA transactions decreased significantly after 1988. Of the 679 failed or failing banks the FDIC handled from 1989 through 1994, only 7 were resolved by open bank assistance. The last OBA occurred in 1992. Two options, bridge bank authority and cross guarantee authority, that gave the FDIC additional flexibility in resolving large failures were not available to the FDIC when First City made its request for OBA. By the time the FDIC approved First City's OBA in principle on September 9, 1987, it had just received authority to create bridge banks on August 10, 1987, with the passage of the Competitive Equality Banking Act. The FDIC did not believe it would be appropriate to test the new authority and new procedures with such a large and complex institution.[52] Furthermore, the FDIC did not receive its cross guarantee authority until 1989, with the passage of FIRREA. If the FDIC had possessed cross guarantee authority in 1987, the OBA might not have been the least costly transaction, because the solvent banks could have supported the losses of the insolvent ones.[53]

Another reason for providing OBA was concern that if two of the holding company's banks were closed, bank runs might be generated in the other First City banks, thus creating liquidity problems. Any First City banks that survived would have been a benefit to the holding company's shareholders, and any banks not strong enough to endure the liquidity pressures might have continued to deteriorate until they, too, had to be closed, thereby eventually increasing the costs to the FDIC.[54]

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51. Others include the BancTexas Group, Dallas, Texas, which received assistance on July 17, 1987, but whose lead bank failed on January 26, 1990. The same group of investors that put together the BancTexas transaction received OBA for two banks in Alaska on January 28, 1988, but those two banks failed in April 1989.

52. The FDIC used its bridge bank authority for the first time when Capital Bank & Trust Company, Baton Rouge, Louisiana, was closed on October 30, 1987. The bank had $386.3 million in total assets. FDIC, *1987 Annual Report,* 6. See Part I, Resolution and Asset Disposition Practices, Chapter 6, Bridge Banks, for a full discussion of this subject.

53. McAllen State Bank, McAllen, Texas, with assets of approximately $590.7 million, was closed April 19, 1988. The only other First City banks that were insolvent and eligible to be closed in 1987 were First City Dallas and First City Houston, with $510 million and $3.8 billion in assets, respectively.

54. Stone, letter to James L. Bothwell, Director, Financial Institutions and Market Issues, General Accounting Office (October 24, 1994); "Failing Banks: Lessons Learned from Resolving First City Bancorporation of Texas," 36.

Some banking analysts thought the assistance provided to First City was inadequate to recapitalize the organization, but the key to the FDIC's granting the OBA in 1988 was A. Robert Abboud and his desire to complete the transaction. Abboud had indicated that he and his investment group could raise $500 million from the private sector and that, with the assistance of the FDIC, First City could be recapitalized. Former FDIC Chairman William L. Isaac was quoted later as believing that the original assistance was insufficient. "There's no question the deal was too thin," he reported. "I thought there was about a 25 percent chance [that Abboud's] deal would not work. Those odds are too high."[55] In his book, published in 1993, former FDIC Chairman Seidman said, ". . . [W]e probably drove too tough a deal with Abboud, which did not leave him enough money to save the bank. Others were bidding, and we took the best bid. It turned out that the bid that gave the most money to the government was too good, because the bank failed again late in 1992. . . ."[56]

A big question the FDIC faced concerning the First City transaction was, "Why did First City fail the second time?" A report from the GAO cited the continued decline in the Texas economy, weak loan portfolios in the First City banks, questionable lending activity, and high bank operating expenses.[57] After First City was recapitalized, its management was under pressure to produce returns for the new investors. The First City banks embarked on a short-lived aggressive growth policy that resulted in portfolios including loans to finance highly leveraged transactions, international loans, and out-of-territory loans. During the first two years after receiving its assistance, First City reported $183 million in profits and paid $122 million in cash dividends. However, the earnings used to justify the dividends were profits that depended on income from non-traditional and one-time sources, including the sale of First City's credit card operations in the first quarter of 1990. That sale enabled the holding company to turn a $49 million loss from operations into a $90 million profit in that quarter. In addition, the holding company was not able to achieve the operational cost-cutting it had projected and, in 1990 and 1991, operating costs increased while net income, gross profits, and total assets decreased.[58]

Bridge Bank and Purchase and Assumption—1992

In 1992, the FDIC was able to use effectively both the cross guarantee authority and the bridge bank authority in the resolution of the First City failures. The FDIC thus had more resolution options than it had when First City was originally given assistance in 1988. The cross guarantee assessment resulted in the reduction of the costs of the fail-

55. Milligan, "Who Shot First City," 43; Heath, *Bank Failures (Texas)*, 17.

56. Seidman, *Full Faith and Credit*, 146.

57. "Failing Banks: Lessons Learned from Resolving First City Bancorporation of Texas," 5.

58. "Failing Banks: Lessons Learned from Resolving First City Bancorporation of Texas," 4-5, 12, 34.

Table II.5-3

Summary of Loss Sharing Agreements for Failed First City Banks As of March 31, 1997 (Agreements Fully Terminated)
($ in Millions)

	Failed Bank	Total Loss Sharing Assets	Total FDIC Loss Sharing Payments	Payments as % of Covered Assets*
1	First City Texas-Austin**	$ 89	$ 0	0.56
2	First City Texas-Dallas	602	3	0.50
3	First City Texas-Houston	1,824	79	4.33
	Totals	**$2,515**	**$82**	**3.26**

*Percentages are not reflective of rounding.
**Total FDIC payments for the First City Texas-Austin loss sharing agreement are less than $500,000.
Source: FDIC, *Summary of Loss Sharing Assistance Agreements Through March 31, 1997* (June 26, 1997).

ures, because the solvent banks lowered the insurance fund's losses. The FDIC believed that bridging the failed banks provided investors with the opportunity to find the time and resources necessary to produce the unusually high premiums for the First City franchises. The marketing that allowed for 42 institutions to perform due diligence over a seven-week period and resulted in bids from 30 potential acquirers would not have been possible had the banks been open and not under FDIC control.[59]

The process of allowing separate bids for each of the First City banks allowed more competitive bidding and higher premiums than had been expected. The total premium received for all bridge banks was $434 million. The 20 bridge banks were sold to 12 separate acquirers, consisting of 8 independent banks or holding companies located primarily in Texas, 1 thrift institution located primarily in Texas, and 3 bank holding companies located or controlled primarily out of that state.[60] Six of the acquirers were part of bank groups or holding companies with less than $1 billion in total assets. With the exception of Texas Commerce, each acquiring institution had aggregate bank and affiliate assets of less than $5 billion.[61]

The loss sharing agreements with purchasers of three First City banks (Austin, Dallas, and Houston) were also viewed as successful. The FDIC's total loss sharing pay-

59. "Failing Banks: Lessons Learned from Resolving First City Bancorporation of Texas," 38.

60. FDIC News Release, PR-7-93.

61. Holland, 158; Heath, *Bank Failures (Texas)*, 29-30.

ments were $82 million, or 3.26 percent of total covered assets of $2.5 billion. A summary of the loss sharing transactions is shown in table II.5-3.

Effect on Future Resolutions

The original OBA for First City took more than seven months to complete. The FDIC, which had negotiated many OBA transactions in the past, grew dissatisfied with the unusual difficulties involved in completing First City's assistance transaction. When the FDIC was asked to work with First Republic, the First City transaction was not yet complete. Because of the FDIC's experience in working with First City's shareholders and holding company debtholders, structuring a bridge bank resolution for First Republic, even without cross guarantee authority, was a simpler method of dealing with First Republic's problems. See chapter 6 of part II for a complete description of the First Republic transaction.

Tables II.5-4 and II.5-5 show the First City banks involved with each transaction.

Table II.5-4

First City Bancorporation Subsidiary Banks, April 20, 1988

($ in Thousands)

	Bank Name, City, State	Resolution Assets	Resolution Deposits	Resolution Cost	Assets Passed	FDIC Assets	Res. Cost (%)
1	First City, Texas-Richardson, Richardson, TX	$202,202	$208,656	$1,779	$202,202	$0	0.88
2	First City, Texas-Dallas, Dallas, TX	509,653	483,968	81,461	509,653	0	15.98
3	First City, Texas-Beaumont, Beaumont, TX	386,313	395,218	12,670	386,313	0	3.28
4	First City, Texas-Bryan, Bryan, TX	205,855	204,568	1,583	205,855	0	0.77
5	First City, Texas-Graham, Graham, TX	115,841	123,260	563	115,841	0	0.49
6	First City, Texas-Lufkin, Lufkin, TX	135,181	138,029	534	135,181	0	0.39
7	First City, Texas-Madisonville, Madisonville, TX	77,414	80,968	146	77,414	0	0.19
8	First City, Texas-Midland, Midland, TX	311,822	309,816	17,247	311,822	0	5.53
9	First City, Texas-Orange, Orange, TX	103,312	108,481	452	103,312	0	0.44
10	First City, Texas-Richmond, Richmond, TX	64,454	69,979	357	64,454	0	0.55
11	First City, Texas-San Angelo, San Angelo, TX	120,374	129,306	1,115	120,374	0	0.93
12	First City, Texas-Tyler, Tyler, TX	226,004	230,044	23,311	226,004	0	10.31
13	First City, Texas-Lewisville, Lewisville, TX	113,217	120,675	2,489	113,217	0	2.20

Table II.5-4

First City Bancorporation Subsidiary Banks, April 20, 1988

($ in Thousands)

Continued

	Bank Name, City, State	Resolution Assets	Resolution Deposits	Resolution Cost	Assets Passed	FDIC Assets	Res. Cost (%)
14	First City, Texas-Humble, Humble, TX	$67,660	$75,791	$5,565	$67,660	$0	8.22
15	First City, Texas-Sour Lake, Sour Lake, TX	39,524	41,804	17	39,524	0	0.04
16	First City, Texas-Houston, N.A., Houston, TX	3,819,064	2,160,951	742,348	3,819,064	0	19.44
17	First City, Texas-Austin, Austin, TX	613,430	594,778	79,626	613,430	0	12.98
18	First City, Texas-Lake Jackson, Lake Jackson, TX	74,087	77,911	186	74,087	0	0.25
19	First City, Texas-Grand Prairie, Grand Prairie, TX	68,464	73,491	145	68,464	0	0.21
20	First City, Texas-El Paso, El Paso, TX	338,309	335,465	931	338,309	0	0.28
21	First City, Texas-Arlington, Arlington, TX	207,888	215,043	19,446	207,888	0	9.35
22	First City, Texas-Kountze, Kountze, TX	29,871	31,855	28	29,871	0	0.09
23	First City, Texas-Alice, Alice, TX	91,446	94,459	570	91,446	0	0.62
24	First City, Texas-East Dallas, Dallas, TX	91,366	95,508	754	91,366	0	0.82
25	First City, Texas-Gateway, Beaumont, TX	66,030	70,722	50	66,030	0	0.07
26	First City, Texas-Central, Beaumont, TX	60,016	64,139	335	60,016	0	0.56
27	First City, Texas-Farmers Branch, Farmers Branch, TX	139,828	147,861	4,296	139,828	0	3.07
28	First City, Texas-Windsor Park, San Antonio, TX	109,502	117,314	8,804	109,502	0	8.04
29	First City, Texas-Garland, Garland, TX	112,070	118,849	1,656	112,070	0	1.48
30	First City, Texas-Market Center, Dallas, TX	58,716	63,382	5,857	58,716	0	9.98
31	First City, Texas-Northline, Houston, TX	53,071	60,370	6,071	53,071	0	11.44
32	First City, Texas-Central Park, San Antonio, TX	153,102	168,399	26,739	153,102	0	17.46
33	First City, Texas-Lancaster, Lancaster, TX	70,251	75,313	522	70,251	0	0.74
34	First City, Texas-Aransas Pass, Aransas Pass, TX	42,204	44,373	209	42,204	0	0.50
35	First City, Texas-Almeda Genoa, Houston, TX	67,291	70,712	207	67,291	0	0.31
36	First City, Texas-Valley View, Dallas, TX	123,139	131,368	4,777	123,139	0	3.88
37	First City, Texas-Gulfgate, Houston, TX	145,171	152,769	271	145,171	0	0.19
38	First City, Texas-Colleyville, Colleyville, TX	$47,521	$48,181	$207	$47,521	0	0.43

Table II.5-4

First City Bancorporation Subsidiary Banks, April 20, 1988

($ in Thousands)

Continued

	Bank Name, City, State	Resolution Assets	Resolution Deposits	Resolution Cost	Assets Passed	FDIC Assets	Res. Cost (%)
39	First City, Texas-Clear Lake, Houston, TX	$68,882	$73,856	$1,406	$68,882	$0	2.04
40	First City, Texas-Highland Village, Houston, TX	127,326	136,717	3,682	127,326	0	2.89
41	First City, Texas-Bellaire, Bellaire, TX	44,128	48,064	1,465	44,128	0	3.32
42	First City, Texas-Inwood Forest, Houston, TX	65,818	70,911	1,694	65,818	0	2.57
43	First City, Texas-Corpus Christi, Corpus Christi, TX	381,259	308,890	6,272	381,259	0	1.65
44	First City, Texas-Forest Hill, Forest Hill, TX	38,703	41,348	173	38,703	0	0.45
45	First City, Texas-Medical Center, Houston, TX	45,273	48,660	159	45,273	0	0.35
46	First City, Texas-Fondren South, Houston, TX	53,939	59,232	3,064	53,939	0	5.68
47	First City, Texas-Central Arlington, Arlington, TX	78,909	82,145	3,065	78,909	0	3.88
48	First City, Texas-Northeast, Houston, TX	61,350	66,393	642	61,350	0	1.05
49	First City, Texas-Bear Creek, Harris County, TX	39,719	43,450	1,192	39,719	0	3.00
50	First City, Texas-Westheimer, Houston, TX	57,870	62,969	2,217	57,870	0	3.83
51	First City, Texas-North Belt, Houston, TX	48,942	52,757	620	48,942	0	1.27
52	First City, Texas-Plano, Plano, TX	51,352	57,748	2,042	51,352	0	3.98
53	First City, Texas-Fort Worth, Fort Worth, TX	50,738	56,603	4,965	50,738	0	9.78
54	First City, Texas-Northchase, Houston, TX	46,241	50,036	1,606	46,241	0	3.47
55	First City, Texas-Westheimer Park, Houston, TX	54,051	60,359	5,431	54,051	0	10.05
56	First City, Texas-Westwood, Houston, TX	22,122	25,358	2,758	22,122	0	12.47
57	First City, Texas-San Antonio, San Antonio, TX	41,196	44,944	3,258	41,196	0	7.91
58	First City, Texas-Northwest Highland, Austin, TX	45,485	50,513	1,784	45,485	0	3.92
59	First City, Sioux Falls, N.A., Sioux Falls, SD	516,036	225,270	0	516,036	0	0.00
	Totals	**$11,200,002**	**$9,399,999**	**$1,100,819**	**$11,200,002**	**$ 0**	**10.29**

Source: Division of Research and Statistics.

Table II.5-5

First City Bancorporation Subsidiary Banks, February 13, 1993

($ in Thousands)

	Bank Name, City, State	Resolution Assets	Resolution Deposits	Resolution Cost	Assets Passed	FDIC Assets	Res. Cost (%)
1	New First City, Texas-Tyler, Tyler, TX	$254,063	$225,916	$0	$244,573	$9,490	0.00
2	New First City, Texas-San Angelo, San Angelo, TX	138,948	127,802	0	133,994	4,954	0.00
3	New First City, Texas-Midland, Midland, TX	312,987	289,021	0	302,502	10,485	0.00
4	New First City, Texas-Orange, Orange, TX	128,799	119,544	0	127,918	881	0.00
5	New First City, Texas-Houston, NA, Houston, NA	3,575,886	2,240,292	0	3,115,360	460,525	0.00
6	New First City, Texas-Madisonville, Madisonville, TX	119,821	111,783	0	119,132	689	0.00
7	New First City, Texas-Sour Lake, Sour Lake, TX	54,145	49,701	0	53,280	865	0.00
8	New First City, Texas-Lake Jackson, Lake Jackson, TX	102,875	95,416	0	100,729	2,147	0.00
9	New First City, Texas-Austin, Austin, TX	346,981	318,608	0	289,561	57,420	0.00
10	New First City, Texas-Graham, Graham, TX	94,446	85,667	0	93,505	941	0.00
11	New First City, Texas-El Paso, El Paso, TX	397,859	367,305	0	380,741	17,118	0.00
12	New First City, Texas-Kountze, Kountze, TX	50,706	46,481	0	50,584	122	0.00
13	New First City, Texas-Alice, Alice, TX	127,990	119,187	0	122,784	5,206	0.00
14	New First City, Texas-Aransas Pass, Aransas Pass, TX	54,406	49,806	0	52,495	1,910	0.00
15	New First City, Texas-Corpus Christi, Corpus Christi, TX	475,869	390,311	0	420,950	54,919	0.00
16	New First City, Texas-San Antonio, San Antonio, TX	262,538	244,960	0	235,164	27,374	0.00
17	New First City, Texas-Lufkin, Lufkin, TX	156,766	146,314	0	154,705	2,061	0.00

Table II.5-5

First City Bancorporation Subsidiary Banks, February 13, 1993

($ in Thousands)

Continued

	Bank Name, City, State	Resolution Assets	Resolution Deposits	Resolution Cost	Assets Passed	FDIC Assets	Res. Cost (%)
18	New First City, Texas-Beaumont, Beaumont, TX	$531,489	$489,891	0	$514,907	$16,582	0.00
19	New First City, Texas-Bryan, Bryan, TX	340,398	315,788	0	334,031	6,367	0.00
20	New First City, Texas-Dallas, Dallas, TX	1,324,843	1,224,135	0	1,171,946	152,897	0.00
	Totals	**$8,851,815**	**$7,057,928**	**$0**	**$8,018,861**	**$832,953**	**0.00**

Source: Division of Research and Statistics.

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Potential acquirers of the failed First National Bank of Midland, Midland, Texas, meet with FDIC officials in Washington, D.C., to make their bids to assume the deposit liabilities of the closed bank. The succesesful bidder was RepublicBank First National Midland.